

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:PA:APJP:B01:MEHara
POSTS-120510-05

date: May 5, 2005

to: Grace Davis
Senior Program Analyst
E-application and Technology Section
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OS:CIO:I:ET:S:TP:ETS

from: James C. Gibbons
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(Procedure & Administration)

subject: ETA Request for Advice - Denial of Application or Suspension of IRS *e-file* Providers for Criminal Activity Prior to Conviction

This is in response to your request for advice dated April 13, 2005, regarding the denial of an *e-file* Provider application or suspending IRS *e-file* Providers for criminal activity prior to conviction.

ISSUE:

Whether the Internal Revenue Service (IRS) can establish a rule providing for the denial of an *e-file* Provider application or suspending IRS *e-file* Providers for criminal activity prior to conviction.

CONCLUSIONS:

The IRS can establish a rule providing for the denial of application or suspension of IRS *e-file* Providers for criminal activity prior to conviction because the ability to file returns electronically is not a Constitutionally protected property or liberty interest. The rule providing for the denial of an *e-file* Provider application or suspension of an IRS *e-file* Provider for criminal activity prior to conviction should, however, be clearly and unambiguously set forth in Publication 3112, IRS *e-file* Application and Participation.

The IRS should produce evidence supporting its denial or suspension of the participant from the *e-file* Program. In this regard, however, IRS civil access to law enforcement databases raises some procedural obstacles since access to the National Crime Information Center (NCIC) is limited by statute and policy to agencies engaged in the "administration of criminal justice". The Federal Bureau of Investigation Criminal Justice Information Service Division has determined that NCIC data cannot be accessed when

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conducting suitability checks of proposed applicants for the IRS *e-file* Program. Since most of the criminal investigative activity will be based on Criminal Investigation (CI) information, however, access to NCIC data should not be an issue. In considering a denial or suspension of a participant based on an active CI investigation, close coordination with CI is necessary.

FACTUAL BACKGROUND:

[REDACTED]

[REDACTED]

You have asked our office if we have any legal concerns if ETA establishes such new *e-file* rule and also asked for advice on the crafting of language for the *e-file* rule.

ANALYSIS:

The IRS can establish a rule providing for the denial of application or suspension of IRS *e-file* Providers for criminal activity prior to conviction.

The IRS can establish a rule providing for the denial of application or suspension of IRS *e-file* Providers for criminal activity prior to conviction because the ability to file returns electronically is not a Constitutionally protected property or liberty interest. Although applicants and participants have filed suit challenging the denial of their *e-file* Provider application or suspension from the *e-file* Program, courts have dismissed due process claims filed regarding the Service's *e-file* Program, holding that the ability to file returns electronically is not a Constitutionally protected property or liberty interest.

In *Sabat v. Internal Revenue Service*, 2000-1 USTC ¶ 50,328 (W.D. Pa. 2000), Nicholas Sabat plaintiff filled out an application to participate in the IRS electronic filing program for individual income tax returns. In Question 4 of the application, applicants are asked whether they have ever been convicted of a monetary crime or any criminal offense under the United States Internal Revenue laws. Sabat answered both questions in the negative. The IRS sent a letter to Sabat, indicating that it had received his application to participate in the electronic filing program and noting that the first part of the process in considering an application is a "suitability check" to protect the integrity of the program and its participants, which can take up to 45 days. When the suitability check was performed, the fingerprint check revealed that Sabat had been arrested numerous times between 1982 and 1995, and that he had been convicted of rape in 1983 and recklessly endangering another person in 1990. In addition, the tax compliance check showed that Sabat had failed to file income tax returns up to 1995. Based on the information revealed in the fingerprint check and the tax compliance check, the Criminal Investigation Division of the IRS recommended that Sabat's application to participate in the electronic filing program be denied. Sabat was notified that his application to participate in the IRS electronic filing program had been denied "based on the information received from the Federal Bureau of Investigation, which indicated conduct of a disreputable nature reflected by your arrest record."

After exhausting his administrative appeals, Sabat sought a declaration that he had not violated any Service procedures, and thus he was eligible to participate in the Service's e-file program. The government filed a motion to dismiss plaintiff's complaint under FED.R.CIV.P. 12(b)(6). In granting the motion to dismiss, the court stated:

Turning to plaintiff's due process claim, the court concludes that plaintiff has failed to state a claim upon which relief may be granted. The Fifth Amendment to the United States Constitution provides, in relevant part, that the government may not deprive any person "of life, liberty, or property without due process of law." As noted by defendants, to prevail on a due process claim, a plaintiff must establish: (a) a constitutionally protected life, liberty or property interest; (b) government deprivation of that interest; and (c) the inadequacy of the procedures accompanying the deprivation. See, e.g., *Lehr v. Robertson*, 463 U.S. 248, 256 (1983). ... In the present case, plaintiff has failed to establish a constitutionally protected liberty or property interest in participating in the IRS electronic filing program. In addition, the court agrees with the government that, even if plaintiff had established a protected liberty or property interest, his procedural due process rights were not violated because the denial was authorized by a provision of the Revenue Procedure, and plaintiff was notified of his appeal rights and exercised them. ... Under the circumstances, plaintiff's complaint will be dismissed... (footnote omitted).

See also *Forehand v. Internal Revenue Service*, 877 F. Supp. 592 (M.D. Ala. 1995) (participation of tax preparer in Program did not amount to property interest for due

process purposes, and suspension from the program did not violate protected liberty interest); *Ekanem v. Internal Revenue Service*, 98-1 USTC ¶ 50,257 (D. Md. 1998) (suspension from e-file program for violation of two provisions of the revenue procedure did not violate plaintiff's procedural or substantive due process rights).

The rule providing for the denial of an e-file Provider application or suspension of an IRS e-file Provider for criminal activity prior to conviction should be clearly and unambiguously set forth in Publication 3112, IRS e-file Application and Participation.

To be upheld by a court, the denial of an e-file Provider application or suspension from the e-file program must be done in accordance with applicable Service regulatory authority, revenue procedures and publications. The Service has authority to regulate tax return e-filers under its general regulatory authority. See *Brenner Income Tax Centers v. Director of Practice*, 87 F.Supp.2d 252, 257 (S.D.N.Y. 2000). In *Brenner*, the IRS suspended an e-file Provider from participation in the ELF Program based on their failure to file a fiscal year Form 1120 corporate income tax return for 1997. In upholding the suspension, the court noted:

The IRS has authority to set guidelines for the exercise of the privilege of participating in the ELF Program, and the Plaintiffs were notified of these requirements. See Rev. Proc. 97-60, 1997-52 I.R.B. 39. The IRS may suspend an electronic filer from participation in the ELF Program with or without prior notice, for "violating any provision" of the Revenue Procedure.

Id. at 257.

The requirements for participants in the IRS e-file Program is set forth in Revenue Procedure 2000-31, 2000-2 C.B. 146. The Revenue Procedure is generally effective as of July 31, 2000, except for section 7, which was effective January 1, 2001.

We are unaware of any successful legal challenge to the regulation of program participants' activities by the revenue procedure. See, e.g., *Brenner Income Tax Centers, Inc. v. Director of Practice*, 87 F.Supp.2d 252 (S.D.N.Y. 2000); *Sabat v. Internal Revenue Service*, 2000-1 USTC (CCH) ¶ 50,328, 2000 U.S. Dist. LEXIS 3974 (W.D. Pa. 2000) (decision that criminal convictions were disreputable conduct not arbitrary, capricious, or an abuse of discretion; no liberty or property interest in participating in program); *Ekanem v. United States*, 98-1 USTC (CCH) ¶ 50,257, 1998 U.S. Dist. LEXIS 2866 (D. Md. 1998) (due process claims rejected after program expulsion); *Forehand v. Internal Revenue Service*, 877 F. Supp. 592 (M.D. Ala. 1995) (no property interest involved in program participation, no liberty interest shown)."

We don't believe that a court would find that the IRS' action in denying an application or suspending IRS e-file Providers for criminal activity prior to conviction is an abuse of discretion. Agencies generally have wide discretion in the choice of remedies or

sanctions. The relation of remedy to policy is peculiarly a matter for administrative competence, and is not to be set aside unless unwarranted by law or without justification in fact. *Butz v. Livestock Com. Co.*, 411 U.S. 182, 185-86, *reh. denied.*, 412 U.S. 933 (1973); *Jacob Siegel Co. v. Federal Trade Commission*, 327 U.S. 608, 611-12 (1946); LEE MODJESKA, ADMINISTRATIVE LAW PRACTICE AND PROCEDURE § 5.9 (Supp. 2001). In *Ekanem v. Internal Revenue Service*, 98-1 USTC ¶ 50257 (D. Md. 1998), the court held that selection of the penalty imposed is not a fact-finding procedure, but the exercise of a discretionary grant of power, and is to be reviewed only for abuse of discretion under an arbitrary and capricious standard of review.

In defending its actions, the IRS would contend that rules denying an application or suspending IRS *e-file* Providers for criminal activity prior to conviction are rationally grounded. As an example to the taxpaying public, trust must be placed on e-filers to possess a high degree of integrity as well as to be in compliance with the Revenue Procedure. *E-file* Providers that are the subject of open IRS criminal investigations, or who have been arrested or indicted by other law enforcement jurisdictions, do not reflect the degree of compliance which the IRS *e-file* Program has established, and they fail to satisfy the minimum requirements necessary for participation in the IRS *e-file* Program. This rationale is certainly not arbitrary or capricious and is "rationally connected" to the choice made to deny an *e-file* Provider's application or to suspend him. *Burlington Truck Lines*, 371 U.S. 156, 168 (1962).

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Disclosure of Reasons Supporting Denial or Suspension.


Finally, the IRS should produce evidence supporting its denial or suspension of the participant from the *e-file* Program. In this regard, however, IRS civil access to law enforcement databases raises some procedural obstacles since access to the National Crime Information Center (NCIC) is limited by statute and policy to agencies engaged in the "administration of criminal justice". The Federal Bureau of Investigation Criminal Justice Information Service Division has determined that NCIC data cannot be accessed when conducting suitability checks of proposed applicants for the IRS *e-file* Program. Thus, obtaining information from other law enforcement agencies may be limited and could be an issue in supporting the denial or suspension of a particular participant. Since most of the criminal investigative activity will be based on CI information, however, access to NCIC data should not be an issue.

In considering a denial or suspension of a participant based on an active CI investigation, close coordination with CI is necessary. Many times, it may be necessary to preserve the secrecy of the existence of an investigation. Such circumstances include an on-going undercover operation or an anticipated search warrant. Additionally, if the criminal investigation is being operated under the auspices of a grand jury, Rule 6(e) of the Federal Rules of Criminal Procedure, which establishes rules for grand jury secrecy, would possibly limit the disclosure of information surrounding the pending criminal investigation. Accordingly, application of a standard based on a current criminal investigation must be coordinated on a case-by-case basis and closely coordinated with CI.

We will happy to work with your office in crafting appropriate language to Publication 3112 to provide for the pre-conviction denial of an *e-file* Provider application and/or the pre-conviction suspension of IRS *e-file* Providers for criminal activity.

We have coordinated this response with the Associate Chief Counsel (Criminal Tax). Please contact this office if you any questions regarding this memorandum.

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By: 
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